



SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1943

No. 129

MORRIS INVESTMENT CORPORATION,
Petitioner,
against

COMMISSIONER OF INTERNAL REVENUE.

**BRIEF IN SUPPORT OF PETITION FOR WRIT OF
CERTIORARI.**

I.

The Opinions of the Courts Below.

The memorandum opinion of the United States Board of Tax Appeals (R. 29-34), promulgated January 5, 1942, was not reported (46 B. T. A. 1276).

The opinion of the United States Circuit Court of Appeals for the Third Circuit (R. 35), is reported in 134 F. (2d) 774.

II.

Jurisdiction.

1. The statutory provision believed by petitioner to sustain the jurisdiction of this Court is Section 240 of the Judicial Code as amended by the Act of February 13, 1925, 43 Stat. 938. 24 U. S. C. A. Sec. 347.

2. The statutes involved are the Revenue Act of 1936, United States Statutes At Large, 1935-1936, Vol. 49, Part I, c. 690, p. 1648; Revenue Act of 1937, United States Statutes At Large, 1937, Vol. 50, Chap. 815; and the Revenue Act of 1942, United States Statutes At Large, Vol. 56, Chap. 619.

The pertinent provisions of these statutes are set out in the Appendix, *infra*, pages 30 to 33.

The sections of the Act quoted in the Appendix are the applicable sections defining the income subject to the Personal Holding Company Surtax and providing for the credits in arriving at "undistributed adjusted net income" of Personal Holding Companies, and giving the amendments contained in the 1942 Act retroactive effect, and providing for the refund of overpayments of tax.

3. The Order for Mandate of the Circuit Court of Appeals, Third Circuit, was issued on the 20th day of April, 1943. This petition was docketed on the 30th day of June, 1943.

4. One of the controlling questions relied upon herein was one of the controlling questions raised upon the record in the United States Board of Tax Appeals. That question was whether or not the deficiency assessed against the petitioner for Personal Holding Company Surtax violated the Federal Constitution Amendments 5 and 14. Such question, and the question of the effect of the Revenue Act of 1942 upon the deficiency assessed against this petitioner for the year 1937 (this Act was not passed until after decision of the Board of Tax Appeals) were the controlling questions raised upon the appeal to the United States Circuit Court of Appeals, Third Circuit. In other words, was not the Personal Holding Company surtax as applied to this deficit corporation (petitioner), unconstitutional, and in any event, was not this deficiency assessment retroactively wiped out by the provisions of the Revenue Act of 1942?

The first of these questions was raised in briefs and arguments before the United States Board of Tax Appeals and its judgment could not have been rendered without deciding the question of the constitutionality of the imposition upon this taxpayer of the Personal Holding Company Surtax as imposed by the Revenue Act of 1936, as amended by the Revenue Act of 1937. The judgment of the United States Circuit Court of Appeals for the Third Circuit could not have been rendered without deciding all of the above questions all of which were raised in the briefs and argument before that court.

III

Statement of the Case.

The facts in this case are few (R. 12-28) and although not stipulated, are undisputed. As found by the Board of Tax Appeals, they are as follows:

The alleged deficiency of surtax on Personal Holding Company amounts to \$56,205.96. It is based upon a computation by the Commissioner of Internal Revenue of "undistributed adjusted net income of \$75,207.94", upon the first \$2,000 of which there is assessed a surtax of 65%, equaling \$1300, and upon the balance a surtax of 75%, equaling \$54,905.96, totaling \$56,205.96 (R. 15).

Petitioner claims that it was not liable for any Personal Holding Company Surtax for the year 1937 for the reason that it had in that year no income which could be lawfully distributed to its stockholders and for the further reason that the said Personal Holding Company Surtax is not really a tax at all, but constitutes a penalty applied for the coercion and destruction of certain corporations, especially if "imposed against deficit corporations", and for the further reason that the Revenue Act of 1942 (Section 501 (a) grants an additional credit to all Personal Holding Com-

panies which are "deficit corporations" by limiting or bringing down the adjusted net income of such Personal Holding Companies to a point where it does not exceed the earnings and profits accumulated between February 28, 1913 and the beginning of the tax year, plus the earnings and profits of the tax year.

The facts upon which petitioner bases its claim that the said deficiency assessment is improper, are as follows:

Petitioner is a Delaware corporation (R. 22).

The Certificate of Incorporation of petitioner was duly executed by the incorporators thereof on the 29th day of December, 1928, and was received and filed in the office of the Secretary of State of the State of Delaware on December 31, 1928 and recorded in the Recorder's Office in Wilmington, in New Castle County, Delaware, on the 31st day of December, 1928 (R. 24-29).

Petitioner's By-laws contained throughout the year 1937 the following provisions in Paragraph 39 thereof:

"Dividends upon the capital stock of the corporation, subject to the provisions of the Certificate of Incorporation, if any, may be declared by the Board of Directors at any regular or special meeting, pursuant to law" (R. 22).

The General Corporation Laws of the State of Delaware did, throughout the year 1937 (Rev. Code of Delaware, 1935, Chap. 65), contain the following provisions:

"Section 34. *Dividends: Reserves:* The directors of every corporation created under this chapter, subject to any restrictions contained in its certificate of incorporation, shall have power to declare and pay dividends upon the shares of its capital stock either (a) out of its net assets in excess of its capital as computed in accordance with the provisions of Sections 14, 26, 27 and 28 of this chapter; or (b) in case there shall be no such excess, out of its net profits for the

fiscal year then current and/or the preceding fiscal year. * * *,

"Section 35. No corporation created under the provisions of this chapter, nor the directors thereof, shall pay dividends upon any shares of the corporation except in accordance with the provisions of this chapter. * * *,

"Section 83. This chapter may be amended or repealed at the pleasure of the Legislature, but such amendment or repeal shall not take away or impair any remedy against any corporation under this chapter, or its officers, for any liability which shall have been previously incurred; this chapter and all amendments thereof shall be a part of the charter of every such corporation except so far as the same are inapplicable and inappropriate to the objects of such corporation."

Petitioner was organized in 1928 to engage in the investment business, and since that date has so engaged (R. 28, 19-21).

During the years 1934 to 1937, petitioner made net losses each year as follows:

- In 1934 a net loss of \$5,730.22.
- In 1935 a net loss of \$3,958.24.
- In 1936 a net loss of \$5,601.99.
- In 1937 a net loss of \$39,952.35 (R. 20).

The losses made subsequent to 1934 reduced the surplus shown on the books to \$30,788.62 at the close of the calendar year 1936, and the 1937 loss wiped out that surplus entirely and left a deficit of \$9,163.73 (R. 20, 21).

However, the undisputed testimony shows that the books overstated by some \$88,000 the true net position of the company. Thus, in 1933 the company's books showed a net profit of \$41,287.20. That was not paid out in dividends, but the stockholders each returned his pro rata share in his personal income tax, and this taxpayer in its return showed

the amount each of the stockholders had returned and had paid a tax or surtax on (R. 21, 22). This was pursuant to Section 104(d) of the Revenue Act of 1932 (47 Stat. Part I. C. 209).

Furthermore, the books of the company, which showed a surplus as of January 1, 1937 of \$30,788.62, failed to record either the above transaction of the stockholders, which was in effect a payment to them of earnings and the lending of it back to the company (R. 21), but also failed to show a loss of \$46,000 (R. 21).

To summarize, the company's entire operations from incorporation to the end of the tax year 1937 showed a loss of \$9,163.73 and a loss of \$39,952.35 for the tax year alone, according to its books. However, those books failed to show the two deductions from surplus above referred to, and therefore, the accounts properly stated should have shown a deficit of approximately \$50,000 at the beginning of the tax year 1937 instead of a surplus of \$30,788.62, which, as above stated, was wiped out by the loss of \$39,952.33 incurred in the tax year (R. 20-22).

While the taxpayer had a substantial statutory income for the tax year 1937, it suffered an actual loss for that year, as above stated, through the sale of capital assets (R. 31).

The Commissioner of Internal Revenue ruled that the failure to pay out the statutory gain made the company liable for \$73,748.67 upon a taxable net income of \$81,414.84 (R. 14, 15), under the undistributed profits tax and the Personal Holding Company Surtax Provisions of the Revenue Act of 1936.

Petitioner appealed to the United States Board of Tax Appeals, which upheld the Commissioner. From that decision petitioner appealed to the United States Circuit Court of Appeals, Third Circuit.

As above stated, a few days prior to the argument, the Revenue Act of 1942 was passed, which amended retroactively the Revenue Act of 1936, and as claimed by petitioner, relieved it from liability under the Undistributed Profits Tax provision and the Personal Holding Company Surtax provision of the Revenue Act of 1936.

The United States Circuit Court of Appeals, as stated above, remanded the cause to the United States Tax Court for further findings as to the effect of the Revenue Act of 1942 on petitioner's liability under the Undistributed Profits Tax, but affirmed the United States Board of Tax Appeals' decision assessing against petitioner for the year 1937 a deficiency for Personal Holding Company Surtax in the amount above stated.

For a review of this decision petitioner submits this petition.

IV.

Assignment of Errors.

A statement of the assignment of errors relied upon will be found in the petition (pp. 4 to 6, *supra*).

V.

Argument.

The petitioner's argument is summarized as follows:

POINT A.

The decision of the court below is in conflict with Section 351 and Section 26 of the Revenue Act of 1936 as amended by Section 501 (a) (2) and (3) of the Revenue Act of 1942 and erroneously imputes to the Congress an intention to remedy a recognized inequity and injustice as to corporations generally but to continue that same injustice in the case of personal holding companies.

POINT B.

Section 351 of the Revenue Act of 1936, as amended by Secs. 353 to 360, inclusive, of the Revenue Act of 1937 (which secs. provide for the taxation of Personal holding corporations) when piled on top of the ordinary corporation income taxes and surtaxes (Secs. 13 and 14 of Revenue Act of 1937) were so excessive as to confiscate petitioner's property, and were unconstitutional and void as applied to this petitioner, a deficit corporation.

POINT C.

The decision below upon each of the above points "A" and "B" presents a substantial Federal question which has not been, but should be, decided by this Court.

POINT D.

The question sought to be reviewed by this Court is of great importance to a very considerable class of income taxpayers and in order to avoid a multiplicity of suits raising the same identical point as hereinabove, should be decided by this Court.

POINT A.

The decision of the court below is in conflict with Section 351 and Section 26 of the Revenue Act of 1936 as amended by Section 501 (a) (2) and (3) of the Revenue Act of 1942 and imputes to the Congress an intention to remedy a recognized inequity and injustice in the case of corporations generally but to continue that same injustice in the case of personal holding companies.

*The Situation in Which Holding Companies Are Left Under
The Revenue Act of 1942.*

In 1936 and 1937 the status of Personal Holding Companies was substantially changed.

First, there was imposed upon all corporations, including Personal Holding Companies, the surtax on undistributed profits, which was enacted in 1936 (49 Stat. c. 690, Sec. 14), and repealed in 1938 (omitted from Rev. Act. 1938, 52 Stat. c. 289).

Second, the statutory income of Personal Holding Companies was changed by the withdrawal of the right to deduct losses in computing statutory net income and the Personal Holding Company Law imposed heavy taxes in addition to the Undistributed Profits Taxes on those Personal Holding Companies which had failed to make distribution of their statutory profits. Sec. 351 (b) (3) of the Revenue Act of 1936 (49 Stat. c. 690) as amended by Sec. 356 (a) of the Revenue Act of 1937 (50 Stat. c. 815).

Third. Regulations 94 (Art. 27 (h) (1)) of the Treasury Department, which is in strict accord with the Revenue Act, shows that a so-called deficit corporation, and certainly one which not only had a deficit at the beginning of the tax year, but also suffered a deficit during that year (R. 20, 21), had no means by which it could escape the heavy imposition of the Undistributed Profits Tax. This was so, because the credit for distribution to stockholders was limited to those distributions which would be taxable in the hands of the stockholders (Sec. 27 (h) of the Revenue Act of 1936). See also Art. 27 (h) 1 of Regulations 94, which is as follows:

“Non-Taxable Distributions.—No dividends paid credit shall be allowed with respect to any part of the

distribution by a corporation to its shareholders, which is—(a) not out of earnings or profits of the taxable year, or out of earnings or profits of the corporation accumulated subsequent to February 28, 1913 (See Section 115), or in case of distributions in liquidation not properly chargeable to earnings or profits of the corporation accumulated after February 28, 1913, under Article 27 (f)-1 * * *. The effect of Subsections (g) and (h) of Section 27 is that no dividends paid credit is allowed with respect to any distribution unless each of the shareholders of that class who are subject to taxation under Title I for the period in which the distribution is made, receives a taxable dividend as a result of the distribution.”

Obviously, if the taxpayer was a deficit corporation, and if the only distributions it could possibly make to its stockholders, whether legal or illegal, would come from capital, then the distribution would not qualify as a deduction under the provisions of the law or the regulations of the Treasury Department, and the luckless corporation would be penalized regardless of what it did with its statutory income.

Doubtless it was this most unfair situation which prompted Congress to take the extraordinary course of amending the Undistributed Profits Tax Law four years after it had been repealed.

It is the contention of the Commissioner of Internal Revenue that the benefit of this remedial Act was not extended to Personal Holding Companies, and that therefore all Deficit Personal Holding Companies are left in the same situation in which they were in 1936 and 1937.

In taking that position, the Commissioner of Internal Revenue completely ignores the fact that Section 501 (a) (3) of the Revenue Act of 1942 amended Section 26 of the Revenue Act of 1936, which applies to every corporation, including Personal Holding Companies.

By this section of the Act of 1942, there was added to Section 26 of the Revenue Act of 1936 a further subdivision (f) entitled "Deficit Credit", which limits or brings down the undistributed adjusted net income of a corporation to an amount not in excess of the accumulated earnings and profits subsequent to February 28, 1913, plus the earnings and profits of the taxable year.

As above stated, it was admitted by the Commissioner and the Circuit Court of Appeals held that said Section 501 (a) (3) applied to Personal Holding Corporations and reduced their adjusted net income.

The amendments to the Revenue Act of 1942 give the same relief to deficit corporations against the harsh provisions of the personal holding company surtaxes as they do against the provisions of the undistributed profits surtax.

As already shown, the Circuit Court recognized that the 1942 Act did relieve deficit Personal Holding Corporations from Undistributed Profit Taxes.

For the convenience of the Court, in the following paragraphs petitioner cites in detail the portions of the Revenue Acts above referred to and their application to the present situation:

The surtax on Personal Holding Companies is contained in Chapter II, Subchapter (a) of the Internal Revenue Code. The Sections covering this surtax are 500 to 506.

The Revenue Act of 1936 also provided for a surtax on Personal Holding Companies found in Title I-A, Section 351. (49 Stat. c. 690).

That Act was amended in 1937 to deprive Personal Holding Corporations of the right they previously had of taking into account their capital losses in computing their net income (Revenue Act 1937 Section 356 (a), (50 Stat. C. 815), compare Section 351 (b) (3) of Revenue Act 1936).

After that the statutory net income of Personal Holding Corporations was the same as for other corporations.

The Revenue Act of 1936 (Section 14 (a) (2) also contains a definition of "Undistributed Adjusted Net Income", which meant statutory net income minus certain stated items, the last of which was in Subdivision (e) of Subdivision 2:

"The amount of the dividends paid credit provided in Section 27 computed without the benefit of Sub-section (b) thereof (relating to the dividend carry-over)."

Referring now to Section 27 of the Revenue Act of 1936, we find that it provides for the corporation credit for dividends paid and said Section 27 contains eight subdivisions, the last of which is Subdivision (h)—"Non-taxable Distributions." This Subdivision provides:

"If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part."

In other words, under the Act of 1936, which, in so far as this particular question is concerned, was in effect during the year 1937, a corporation in order to obtain credit for dividends paid during the year in computing income subject to the Personal Holding Company surtax, must show that those dividends were taxable dividends in the hands of the stockholders.

In the case of the Morris Investment Corporation, had it attempted to avoid the Personal Holding Company Surtax by distributing to its stockholders the entire amount which was taxed as undistributed profits, such distributions would not have been taxable in the hands of the stockholders and

therefore they would not have been deductible from the adjusted net income in determining undistributed adjusted net income. Such a distribution not only would have been contrary to the law of the State of incorporation, (R. 21; see p. 12, *supra*) but would have been a distribution of capital and not taxable in the hands of the shareholders.

It was this compulsion upon the taxpayer to do something which was illegal and for which he could receive no credit if he did do it that caused Congress to amend retroactively the Undistributed Profits Surtax provision, even though that law had been repealed for over four years.

Section 26 (e) of the Act of 1936, has for its Sub-heading "Contracts Restricting Payment of Dividends", and Sub-division 1 of that Subsection (e) has the heading "Prohibition on Payment of Dividends".

The new Revenue Act of 1942 (Section 501 (a) (2) (56 Stat. c. 619) amends Section 26 (e) by changing the heading to read "Restrictions on Payment of Dividends" and by adding a third sub-paragraph 3, which reads:

"Deficit Corporations:—In the case of a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year, the amount of such deficit, if the corporation is prohibited by a provision of a law or of an order of a Public Regulatory Body from paying dividends during the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936."

Section 26 of the Revenue Act of 1936 is further amended by the Revenue Act of 1942 (Section 501 (a) (3)) by the addition of several Sub-paragraphs which are not found in the old 1936 Act. One of these additions is Subdivision (f) entitled "Deficit Credit" and reads as follows:

"The amount by which the adjusted net income exceeds the sum of (1) The earnings and profits accumulated after February 28, 1913, as of the beginning of

the taxable year; and (2) The earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year). For the purposes of this Subsection, earnings and profits of the taxable year shall be computed without diminution by the amount of the tax imposed under Section 14, 102, 103 or 351 for such taxable year; and earnings and profits accumulated after February 28, 1913, as of the beginning of the taxable year, shall be diminished on account of the tax under Section 14, 102, 103 or 351 for any previous taxable year only by the amount of such tax, as computed under the amendment made by Section 501 of the Revenue Act of 1942."

Thus the addition of Subdivision (f) to Section 26 of the Revenue Act of 1936 adds an entirely new credit allowed corporations.

That new credit which applies to all corporations is apparently calculated to bring down the adjusted net income to a point where it will not exceed the earnings and profits accumulated after February 28, 1913, plus the earnings and profits of the taxable year. In this way, if the Company had no net income during the taxable year and had no accumulated earnings it could have no adjusted net income within the meaning of this provision. That is why the Subdivision is entitled "Deficit Credit".

These amendments are made retroactive to the date of the enactment of the Revenue Act of 1936 (Section 501, Subdivision (b) Revenue Act of 1942).

Subdivision (c) of the same section, same Act, provides for the refund or credit of overpayments under the former 1936 Act.

In the case of Personal Holding Companies, there are additional amendments to the Revenue Act of 1936, as

amended by the Revenue Act of 1937 (Sections 353 to 360, inclusive). These amendments are directed to provisions relating to deficiency dividends and consent dividends, and are designed even at this late date to furnish Personal Holding Corporations with means of escape from the unfair provisions of the Undistributed Profits Tax provisions. However, neither of these provisions are of any assistance or benefit to a corporation which is unable legally to declare a dividend and therefore unable to take advantage of the credits allowed corporations in computing Subchapter (a) income.

Congress by providing the additional deduction contained in the new Subdivision (f) added to Section 26 of the Revenue Act of 1936, has relieved all corporations, Personal Holding Companies, as well as others, from being penalized for failure to distribute deficits.

What difference can it make that one section is called a "Surtax on Undistributed Profit" and another section is called a "Surtax on Personal Holding Companies"? The Company is the same. The profits are the same. The restricting and prohibiting State Laws are the same, and the Revenue Act is the same. It would seem that the resulting injustice must likewise be the same.

To summarize the argument of this point:

Section 26 of the Revenue Act of 1936 provides that:

"In the case of a corporation, the following credits shall be allowed to the extent provided in the various sections imposing the tax."

The amendment of 1942 added a subsection (f) of Section 26, the provision above quoted, which allows a credit to the corporation of "the amount by which the adjusted net income exceeds the sum of the earnings and profits accumulated after February 28, 1913, as of the beginning

of the taxable year, and the earnings and profits of the taxable year (computed as of the close of the taxable year, without diminution by reason of any distributions made during the taxable year) * * *." (Sec. 501 (a) (3) of the Revenue Act of 1942.)

Subsection 5 of Section 501 makes that provision retroactive, as stated above.

Although the heading of Section 501 is "Additional Credits for Undistributed Profits Tax", subsection (3) is an amendment of Section 26 of the Revenue Act of 1936 which applies to *all corporations*, including Personal Holding Companies, and the amendment is not specifically restricted to the case of the Undistributed Profits Tax.

It would therefore seem to be applicable in every case where the corporation came within its terms (R. 20-22).

Petitioner's contention in this respect would seem to be fully supported by the fact that the Revenue Act of 1942 also provided retroactively for deficiency dividends by Personal Holding Companies for any year beginning after December 31, 1936, and before January 1, 1938, to wit, the year 1937.

Thus, under the Commissioner's contention, if the Personal Holding Company had something which it could distribute to its stockholders that would be taxable to them, it could make such a distribution now and apply it retroactively against its tax liability for the year 1937, but if it had nothing which it could so distribute, it should not be entitled to the credit given in the amendment by the 1942 Revenue Act to Section 26 of the Revenue Act of 1936, but must be penalized.

The statement of this situation alone would seem to be a complete refutation of the contention of the Commissioner.

POINT B.

Sec. 351 of the Revenue Act of 1936, as amended by Secs. 353 to 360, inclusive, of the Revenue Act of 1937 (which secs. provide for the taxation of personal holding corporations) when piled on top of the ordinary corporation income taxes and surtaxes (Secs. 13 and 14 of the Revenue Act of 1937) were so excessive as to confiscate petitioner's property, and were unconstitutional and void as applied to this petitioner, a deficit corporation.

As a result of all the taxes which are imposed upon a Personal Holding Corporation, if such corporation happened to be a deficit corporation it could well incur taxes which would amount to 120% of its statutory income, when it had been guilty of no violation of any provision of law and was entirely helpless to avoid such situation. The above situation results from the imposition of normal taxes, undistributed profits tax, Personal Holding Company surtax, and surtax under Sec. 102 of the Revenue Act of 1936. The tax actually imposed on this Company amounted to 85.5% of its statutory income (R. 14, 15). These excessive taxes and the impotence of a deficit corporation to avoid them, result as already shown, from the amendment of the Personal Holding Company law in 1937 which deprived Personal Holding Companies of the right to deduct capital losses which they had had prior to that year, coupled with the provision that the only distribution which would relieve any corporation, including a Personal Holding Corporation, from taxation upon its undistributed statutory income were distributions which would be taxable to the stockholders of the corporation.

It is obvious that the provisions with respect to undistributed profits were intended to force corporations to pay dividends to their stockholders so that such distributions in the hands of the stockholders might be taxed to them.

In order to avoid the evasion of this tax Congress provided that the only distributions that should be considered in determining the amount of undistributed profits were distributions that were taxable to the stockholders, but in so doing it completely overlooked the fact that deficit corporations such as the taxpayer which had a deficit in the tax year as well as a deficit over the entire period of its operation to the end of the tax year and a deficit at the beginning of the tax year, were powerless to avoid the imposition of these crushing taxes (R. 20-22).

The situation here presented is fundamentally different from that which was presented in *Helvering v. Northwest Steel Mills*, 311 U. S. 49 and *Crane Johnson v. Helvering*, 311 U. S. 54. In both of those cases the taxpayers had actual net income. Their claim to exemption from the undistributed profits tax was due to deficits which existed at the beginning of the tax year, which deficits the taxpayers claimed made it illegal, under the laws of the States of their incorporation, for them to pay out the profits of the tax year. This Court held that the fact that distributions to avoid the undistributed profits taxes were illegal did not relieve the companies from the taxes. As above shown Congress itself recognized the harshness of its provisions and by the 1942 Revenue Act has adopted provisions under which both of these companies may obtain refunds. The situation here presented however, is fundamentally different, this company having no surplus either at the beginning or end of the tax year, and having made a loss during the tax year could make no payment except from capital (R. 20-22).

Had such a distribution been made it would not have been taxable to the stockholders, and hence would not have entitled the corporation to any deduction from its statutory income in determining its undistributed adjusted net income.

To impose taxes in such circumstances is clearly unreasonable and unconstitutional, as a tax on petitioner's capital and not upon its income, and because the provisions of the Revenue Act of 1936 as amended do not constitute a tax but a penalty for failing to do that which Congress had no power to compel them to do, and for the further reason that the imposition of crushing taxes or penalties upon corporations which could not comply with the intent of Congress and distribute taxable dividends to their stockholders, and upon the further ground that the provisions of said acts which permit the deduction of taxable dividends paid by prosperous companies but which disallowed the deduction of non-taxable dividends (those paid by unsuccessful companies) is a gross and unreasonable discrimination in favor of prosperous companies and against unprosperous ones.

As above stated, the Revenue Act of 1942 not only relieved those companies, such as the Northwest Mills and Crane-Johnson, but also relieves companies which had no net surplus up to the end of the tax year.

If these provisions applied to all corporations, including Personal Holding Corporations, as petitioner argues in the preceding point, Congress has righted the wrong which it did. If, however, they do not so apply, as is argued by the Commissioner, and held by the Court below, then there is still a situation under which deficit personal holding corporations cannot avoid taxation at the rate of 75 per cent upon statutory earnings.

However, the constitutionality of the provisions of the Revenue Acts depends upon the situation which existed in 1937, at which time deficit personal holding companies might well incur taxes of 120 per cent upon statutory income, while powerless to avoid such taxes by distributions to its stockholders because such distributions would not be taxable to such stockholders.

POINT C.

The decision below presents a substantial Federal question which has not been, but should be, decided by this Court.

It is hardly necessary to argue that the interpretation of the language of the Revenue Acts of 1936 and 1942 present a Federal question.

The Revenue Act of 1942 was passd only last October 21st, and there has not been, to petitioner's knowledge, any case before this Court involving the question being herein presented.

POINT D.

The question sought to be reviewed by this Court is of great importance to a very considerable class of income tax-payers and in order to avoid a multiplicity of suits raising the same identical point should be decided and settled by this Court.

It is well-known that there are subject to the Revenue Laws of the United States a great many Holding Companies which fall within the definition of Personal Holding Companies contained in the Revenue Acts.

This Court may take judicial notice of the fact that a very large amount of property is invested in this type of corporation and that in the aggregate a great amount of income is affected by the laws taxing this type of corporation. Probably many of these Personal Holding Companies have, during one or more of the years between 1936 and the enactment of the Revenue Act of 1942, been "deficit corporations", and if petitioner's contention that the amendment to the Revenue Act of 1942 above discussed applies to Holding Companies, is correct, they should be relieved of deficiencies in Personal Holding Company Sur-

tax, either paid or assessed for some one or more of these earlier years.

It is respectfully submitted that an early decision by this Court on the question herein presented will furnish a guide to the Commissioner of Internal Revenue and to the aforesaid Personal Holding Companies, and will settle definitely a question which otherwise will likely result in a great deal of unnecessary litigation. Such clarification will be greatly in the public interest.

Conclusion.

The petition for a Writ of Certiorari should be granted and the decision below reversed.

Dated: June 28, 1943.

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